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All India Congress Committee

SWARAJ BHAWAN,
ALLAHABAD

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J. B. KRIPALANI,
General Secretary.

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1. Indian Currency and Exchange : Its Effects on Indian Trade and Industries

The problem of currency is one of the oldest and most complicated problems of India. In the 19th century India had no uniform monetary system. There were many coins, both of silver and gold of different denominations in circulation side by side, and the money changers carried on a profitable trade to the loss of the general public and the harm of trade. The East India Company, by the Act of 1818, made the silver rupee of 180 grains $11/12$ ths fine unlimited legal tender for South India, where previously gold coins had circulated. The reform begun in 1818 was completed in 1835, when by the Gold and Silver Coinage Act the silver rupee was made unlimited legal tender and the gold coins were deprived of their legal tender character in the whole of British India. Thus began the silver standard which lasted almost without interruption until 1893.

2. Indian Silver Standard 1835-1893

The silver standard in India, to make it explicit, was a purely metallic standard, inasmuch as the standard currency, *i. e.*, the rupee was made of silver (165 troy grains pure), and even the half-rupee, quarter-rupee, and one-eighth of a rupee were also of the same metal as the principal coin, and they contained exactly one-half, one-fourth, and one-eighth of the weight of pure silver in a rupee. All the coins were legal tender (*i. e.*, acceptable in the discharge of monetary obligations), the rupee and half-rupee without limit, and others up to one rupee only.

Everyone had the right of converting silver bullion into silver coins by taking it to the open mint, and everyone was at liberty to convert silver coins into silver bullion by

the simple process of melting them. The coinage was not gratuitous. Seigniorage was charged, but the seigniorage was small (2per cent.) and therefore, of little consequence. The value of the Indian rupee depended on the value of silver, fluctuations in one corresponding almost exactly with those in the other.

The only coins which were token (i.e whose face value was higher than the intrinsic value) were of the lowest denominations, namely, double pice ($1/32$ rupee), pice ($1/64$ rupee) and pie ($1/192$ rupee) whose issue was authorised by section I of Act XXI (not XVII) of 1835, and the half-pice ($1/128$ rupee), introduced by section II of Act XI of 1854. But their token character was lost sight of in their insignificant values, and very few people realised that in the monetary system they were rated higher than their metallic value and that this higher value was maintained by the fact that at that rate there was sufficient demand for them.

In 1861 paper currency was added to the metallic currency, but in the beginning the paper currency formed only a small proportion of Indian currency. Such notes as circulated were identical in value with silver rupees, for the former were in fact, as in law, convertible into the latter.

So simple a currency system was, however, complicated by the issue of gold coins which, by the way, were the only coins not legal tender, but which, like the unlimited legal tender rupees, were also open to free coinage. It was a perfectly anomalous position. The very Act of 1835 which put India on the silver basis permitted by section VII the free coinage of a gold *mohur*, or fifteen-rupee piece, of the weight 180 grains $11/12$ th fine (same weight and fineness in gold as of the rupee in silver), and of five-rupee and ten-rupee gold pieces of the same fineness and proportionate

weight as the *mohur*. The issue of a thirty-rupee gold piece was authorised by the Consolidating Act (XXIII) of 1870.

In 1837 mint certificates of gold were made receivable in payment of taxes and exchangeable against silver rupees. After four years, by a notification in January 1841, the receipt of gold coins minted under the Act of 1835 was authorised at Government treasuries at the rates indicated by the denominations of the pieces. In issuing such notifications the authorities evidently overlooked the simple application of Gresham's Law, with which even a schoolboy is familiar, for no gold could be tendered when it was undervalued at the rate fixed, as it normally was. On the other hand, large quantities were tendered when it was overvalued and this occurred after the gold discoveries in California and Australia (1848-51) had led to a fall in the value of the yellow metal. Then the notifications of 1837 and 1841 were repealed by Lord Dalhousie (1st January, 1853), and gold was demonetised.

MOVEMENT FOR GOLD

Throughout the sixties and the seventies of the last century there was a powerful and widespread movement in the country for gold currency. In its issue the bankers saw that they would profit in changing gold for silver coins. In 1859 a representation was made by the Indian shroffs and merchants of Calcutta, while in 1864 the commercial communities of Bombay, Calcutta and Madras sent several memorials to Government pressing on them desirability of issuing gold currency.

Closely following the gold movement, two events during the nineteenth century deserve special mention. They are (1) the Mansfield Commission and (2) the change in the silver market. The first in spite of its importance has been ignored by many writers on Indian Currency, the second had such

far-reaching consequences in India that it sounded the death-knell of the Silver Standard.

MANSFIELD COMMISSION OF 1866

The Commission appointed by the Government of India on 3rd February, 1866, with Sir William Mansfield as Chairman, was the first of its kind set up in India. The Commission distinguished itself by making as early as 1866 two important recommendations, viz.: (1) the introduction of a 'universal note' and (2) the introduction of a gold currency. The first recommendation was carried out as in 1909, when for the first time the five-rupee note was made 'universal' for the *whole* of India; the second recommendation forms the subject of acute controversy and doubt at the present time.

✓ SILVER SLUMP, 1872-92

From 1872 onwards the silver market experienced a severe slump. The value of silver in relation to gold kept on falling or, which is the same thing, the value of gold in terms of silver kept on rising. This was due to an unusual combination of causes which need not detain us. The important fact to note is that during the two decades preceding 1872 gold was practically throughout $15\frac{1}{2}$ times as valuable as silver while in the two decades following 1872 gold rose to be 27 times as valuable as silver. The average price of silver in London was $60\frac{3}{4}$ d. per oz. in 1872 and 39 d. in 1892, while the exchange rate of the rupee averaged 1 s. 11 d. in 1872 and 1 s. 3 d. in 1892. With a fall in the value of silver a fall in the value of the silver rupee was inevitable, because, as already pointed out, the silver rupee was then freely minted, so that its face value approximated closely to the value of the amount of silver in it. During this difficult period of over two decades the Government of India was faced with a two-fold problem.

There was first the financial problem, for with every fall in the sterling value of the rupee the burden of the Home Charges increased and the certainty of the Government finances diminished. There was, secondly, the economic problem, since instability in the value of the rupee caused great anxiety to the merchants and great injury to India's foreign trade.

DEPARTURE FROM SILVER, 1893

After prolonged discussion of the problem, in 1893 India decided to maintain the value of the rupee by deliberately abandoning the silver standard. To put the matter differently, the rupee departed from silver with the avowed object of maintaining its parity with the gold without interference from fluctuations in the value of silver bullion. This did not mean that the rupee gave up or even altered its silver body, for in fact it embodied, as before, 180 grains of standard (11/12ths fine) silver. The departure from silver meant that the rupee in its value was no longer identified with a weight of silver; it was given a lower value as bullion than as coin. The former value depended, of course, on the particular market price of silver—e.g., it was 1s. 3d. in 1893 with silver at 39d. per standard ounce, 10d. in 1915 with silver at 27d.; the latter value recommended by the Herschell Committee in 1892 was 1s. 4d. per rupee.

This rating of the rupee higher than its bullion value had two obvious merits to recommend it. In the first place, a fall in the gold value of silver bullion need not have caused a fall in the gold value of silver coin (the rupee), so long as the principle of 'token' currency was kept in action. In the second place, a rise in the gold value of silver bullion need not have caused a rise in the gold value of silver coin (rupee), so long as the margin between its face and bullion values did not entirely disappear. Of this more presently.

RECOGNITION OF AN IMPORTANT MONETARY PRINCIPLE, 1893-98

The principle of 'token' currency is one which now looks quite simple. In those days, however, it was but imperfectly understood, although it had been stressed by Professor Cannan in his earliest writings. In Cannan's own words the principle is that, 'given demand for a coin, adequate restriction of supply will keep its value up to any required level above that of its metallic contents.' It found complete illustration in India, when the restriction in the supply of the silver rupee gradually led to a rise in its value from 1s. 2½d. in 1893 to very nearly 1s. 4d. (15.978d.), the rate aimed at in 1898.

SILVER AS TOKEN CURRENCY

It may be of interest to note here that the Indian rupee became *token* as part of a planned system, as contrasted with the English silver coins which became token 'more by accident than by design of the State or of monetary theorists.' Further, since the silver rupee and other silver coins in India were all of the same fineness and proportionate weight, the moment the rupee became a token coin, other coins automatically fell in the same category, for no change was made in their composition.

EVOLUTION OF THE EXCHANGE STANDARD, 1898-1916

The position was again reviewed in the first half of 1898 by the Fowler Committee, which recommended a Gold Standard with gold currency, but circumstances into which we need not go did not permit India to adopt the recommendation. Instead India evolved a monetary system of her own which neither the Fowler nor the Herschell Committee nor even the Mansfield Commission had ever contemplated. The basis of the new system is not to be found in any legislative enactment; it grew of itself from executive prac-

tice and depended on the executive will. It was distinguished by two special features.

In the first place, there was the use of two currencies—the silver rupee and the gold pound—one for local and the other mainly for international purposes. In the second place, there was an interesting mechanism by which the value of the local currency, the rupee, was maintained in terms of the English currency, the pound sterling (itself based on gold), at a certain maximum rate.

The value of the rupee having reached the level of 1s. 4d. in 1898, the Government attempted to prevent any further rise by the devices of (1) accepting sovereigns and half-sovereigns at Rs. 15 to the pound sterling; (2) issuing notes and silver rupees in exchange for gold coin and bullion at the rate of 1s. 4d. to the rupee; (3) offering Council Bills in exchange for sovereigns in London at a rate approximating to 1s. 4d. On the other hand, the value of the rupee was prevented from falling below approximately 1s. 4d. by (1) restricting or stopping the sale of Council Bills; (2) withdrawing rupees in circulation by means of transfers to the Paper Currency Reserve in India and the use of the equivalent of the same amount by the Secretary of State in England; (3) selling Reverse Councils at a rate of 1s. $3\frac{2}{3}\frac{9}{2}$ d.

Thus the currency system of India from 1898 onwards was a system built up and managed by executive action in which the rupee was unlimited legal tender and the right was given by Ordinance to demand rupees for gold, but not to demand gold for rupees. All was well so long as the Government was both willing and able to give at 1s. 4d. parity not only rupees in exchange for sovereigns or gold, but also sterling in exchange for rupees. But trouble ensued if it was either unwilling to do so, as in 1907, or unable, as in 1916, owing to causes which will be explained later.

In the light of the foregoing, it would appear that the monetary system of India from 1898 to 1916 was an exchange standard. But it was not, strictly speaking, a gold exchange standard, for there was no obligation on the currency authority during this period to give gold in exchange for the local standard currency (the silver rupee). It was a sterling exchange standard, which, however, practically amounted to a gold exchange standard, so long as the Secretary of State and the Government of India maintained the interchangeability of rupee into sterling and sterling into rupee.

3. The Currency System during 1916-1925

THE BREAKDOWN IN 1916

The outbreak of the World War inaugurated a revolutionary change in the monetary situation all over the world. The immediate effects of the War were exhibited in India in (1) a great demand for sterling remittances; (2) withdrawals of savings bank deposits; (3) lack of confidence in the note issue, and a demand for gold. All these events were anticipated and dealt with satisfactorily. What was not expected, however, was the unprecedented rise in the price of silver which began in 1916. The fall in the value of silver had led to the value of the rupee being divorced from that of its metallic contents after 1893, but the rise in value of silver restored the former position.

As already explained, the working of the pre-War currency system was based on the willingness and ability of the Government to supply rupees in exchange for gold or sterling, and sterling in exchange for rupees at 1s. 4d. per rupee. Since the silver rupee was a token coin, the former condition depended upon the price of silver being not higher than 43d. per standard oz. (11/12ths fine); for at that price

the exchange value of a rupee at 1s. 4d. coincided with its bullion value. Now the price of silver in 1915 was 27½d., but in April 1916 it had risen to 35 ½d., in December 1916 it was 37d., and August 1917 it reached the level of 43d., at which point the face value of the rupee and its intrinsic value were identical. But this in itself was a source of much trouble to Government, for as the price of silver was still rising, it was obvious that silver rupees could not be offered in exchange for sterling at the rate of 1s. 4d. except at a considerable loss to the State.

On the other hand, the demand for rupees was greatly accentuated owing to two unexpected causes—Viz., (1) an unusually large excess of Indian exports over imports, and (2) heavy expenditure in India on behalf of the British Government. Neither the import of precious metals (for there was an embargo on their movements) nor credits in India were possible. How was the situation to be met?

History repeated itself, and during 1917-19 the rupee was allowed to rise in value—it was impossible to prevent it—along with the rise in the value of Silver, just as during 1872-92 it had fallen in value with the fall in the value of silver. In other words, the sterling exchange standard which had done service for nearly twenty years broke down in 1916, and its place was taken once more by a silver standard. At the same time, to meet the special emergencies of war, exchange was strictly controlled by Government, and Council Bills were offered at rates which were raised from time to time in accordance with changes in the silver position. The price of Silver rose from 43d. in August 1917 to 78d. in May 1919, and to 78d. about the middle of December 1919. The minimum rate for immediate telegraphic transfers was 1s. 4½d. on 3rd January, 1917; 1s. 5d. on 28th August, 1917; 1s. 8d. on 13th May, 1919; and 2s. 4d. on 12th December, 1919.

THE BLUNDER OF 1920

At the end of the War a Committee presided over by Mr. (afterwards Sir) T. Babington Smith reviewed the currency and exchange position, and their most important recommendation was to link the rupee to *gold*—not to sterling—at the rate of 2s. per rupee. In making this recommendation it was largely influenced by two factors *viz.*, (1) the rise in the gold value of silver, and (2) the decline in the gold value of sterling, which was then about 30 per cent. below par. The members seem not to have anticipated either a reversal in the behaviour of the silver market or a rehabilitation of sterling. Actually the subsequent fall in the price of silver outstripped its preceding rise. In February 1920 the price of silver was 89½d. per oz.; four months later, in June 1920, it was less than half (*i. e.*, 44d.) Moreover while the Babington Smith Committee was drafting its report, the British Government was accepting the principles laid down by the Cunliffe Committee, which prescribed a policy of deflation, the effect of which was to force up the value of sterling very rapidly. Left to itself the silver rupee, like a standard coin, should have fallen in value with the fall in the value of silver, and would have been in June 1920 in the neighbourhood of 1s. 4d. sterling. When the price of silver rose during 1916-19 and the silver rupee ceased to be a token coin in the full meaning of the term, Government was compelled to acquiesce in raising the rate of exchange in accordance with the rise of the value of silver. But the authorities did not realise the necessity of reversing the process when the value of silver fell in 1920.

But it might be urged that if Government could keep up the value of the token rupee by adequate restriction of its supply at 1s. 4d., it could also keep it up at a higher level,

say 2s. And was that not the recommendation of the 1909 Committee? Undoubtedly a 2s. gold rupee could be achieved in course of time, given a certain demand for the rupee currency, by *adequate* restriction of its supply; but, other things being equal, what would have been an adequate restriction for 1s. 4d. sterling level would have been quite inadequate for the 2s. sterling level and still less for the 2s. gold level, since sterling in June 1920 was depreciated in terms of gold. But were conditions the same? The demand for silver rupees had changed—a very important factor for the problem in question. About the beginning of 1920 the balance of trade had turned against India; in other words, a fall in the demand for rupees had begun, and its effect could be seen in a fall in the rate of exchange by April 1920 to 2s. 4d. sterling (1s. 10½d. gold). At the same time world prices were falling. All the circumstances, therefore, were unfavourable for artificially raising the value of the rupee. Indeed, to maintain the 2s. gold rupee was impossible except by the necessarily painful process of enormous deflation continued over a period of several years. The Babington Smith Committee had realised that the fall in prices was possible, though it had not regarded it as probable, and included in its report a recommendation that if it should come, the policy of aiming at a 2s. rupee should be reconsidered. It was the least pardonable of the errors of the Secretary of State that he ignored this warning.

The Government announced its acceptance of the recommendations of the Currency Committee of 1919 on the 2nd February, 1920, when the rupee was 2s. 9d. sterling, and declared the rupee equal to 2s. gold or 11.130016 grains of fine gold. Silver had reached its maximum price in the previous December, and a rapid fall had begun, but the deflation policy in relation to sterling only took effect at the

end of March; hence for two months the sterling equivalent of 2s. gold was increasing. In accordance with the declaration of the Government, the Secretary of State started selling Reverse Councils in limited amounts at rates varying between 2s. 3 $\frac{1}{2}$ d. and 2s. 10 $\frac{1}{2}$ d. sterling in accordance with the depreciation of sterling. Financial difficulties, however, made it impossible to withdraw the equivalent in rupees from circulation, an operation through which alone the sale of Reverse Councils could help the maintenance of the value of the rupee. Owing to the course of Chinese trade the gold value of silver, and therefore the bullion value of the rupee, was falling very rapidly; and owing to the fact that instead of the normal great excess of Indian exports of merchandise over imports there was a great excess of imports over exports, the demand for rupees for external trade purposes had disappeared, and had been succeeded by a keen demand for sterling, the offer of Reverse Councils in limited quantities at prices which offered a great profit to the purchasers elicited tenders rising rapidly to fantastic figures, and the failure to satisfy more than an infinitesimal portion of this demand naturally tended to intensify still further the depreciation of the rupee.

After a vast quantity of Indian sterling reserves had been dissipated by selling Reverse Councils, i.e., by buying rupees, at the 2s. gold rate, the Secretary of State reduced his price to 2s. sterling as from 24th June, 1920, the market value having already fallen below this rate, and continued the process up to the 28th September, 1920, much to the indignation of all sections of Indian opinion. The sale of Reverse Councils from the beginning of 1920 totalled £55,382,000, and at the end of this series of transactions the sterling value of the rupees purchased was about £25 millions,

SEPTEMBER 1920 TO AUGUST 1925

From October 1920 till August 1925, when the last Royal Commission on Indian Currency and Exchange was appointed, the exchange was not, as is sometimes supposed, left to look after itself. But it was managed on expedients different from those adopted before. With the stoppage of the sale of Reverse Councils, the exchange, weak as it was, dropped down to as low rate as 1s. 2½d. (under 1s. gold) in March 1921.

According to an official statement, currency was contracted to the extent of Rs. 31 crores 58 lakhs in the year 1920-21 and 'the contraction of currency was continued in 1921-22 and 1922-23 by the transfer of sterling securities held in London to the Secretary of State's cash balance and by the discharge of Indian Treasury Bills held in the Reserve.' This had the effect of restoring the rate to 1s. 4d. sterling by January 1923. Circumstances again became favourable in 1923 and 1924 for an improvement in the rate of exchange, the downward movement in world prices had been temporarily interrupted, the budgetary position was satisfactory, the monsoons were good, and the balance of trade was once again in favour of India. In October 1924 the rate was 1s. 6d. sterling (1s. 4d. gold).

In 1923-24 an important change in the system of Government remittances was introduced. In the past the ~~Secretary~~ of State for India, sold in London, by tender, Council Bills and Telegraphic Transfers once a week, and Intermediates between weekly sales. The sale of the Intermediates was stopped, and the Government of India started purchasing sterling in India through the Imperial Bank from exchange banks and recognised firms. The object of the change, in the words of Government, was 'that the factors influencing the immediate course of exchange could be gauged more

accurately and more promptly in India by regulating the purchases with reference to the varying conditions of the market, the operations of Government could be conducted so as to avoid fluctuations in rates with benefit both to trade and to the country generally.' This had the effect of keeping exchange on the whole steady at 1s. 6d. sterling from October 1924, and since sterling returned to the gold basis in April 1925, the 1s. 6d. sterling coincided with 1s. 6d. gold from that date.

4. The Main Defects of the Currency System

By 1925 currency conditions throughout the world were becoming more stable: in April 1925 England returned to the gold standard and was followed by the Union of South Africa, and by Australia and New Zealand. On the 25th of August, 1925, a Royal Commission was appointed "to examine and report on the Indian exchange and currency system and practice, to consider whether any modifications are desirable in the interests of India and to make recommendations." According to the findings of this commission, the Indian Exchange and Currency system in 1926 suffered from the following main defects:

- (1) "The system is far from simple, and the basis of the stability of the rupee is not readily intelligible to the uninstructed public. The currency consists of two tokens '(silver rupees and currency notes)'; 'in circulation, with the un-necessary excrescence of a third full value coin' (the sovereign) 'which does not circulate at all. One form of token currency' (silver rupees) '(into which there is an unlimited obligation to convert the other)' is highly expensive, and is liable to vanish if the price of silver rises above a certain level,

- (2) There is a cumbrous duplication of reserves, with an antiquated, and dangerous, division of responsibility for the control of credit and currency policy.
- (3) The system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent on the will of the currency authority.
- (4) The system is inelastic. The utility of the provision for elasticity made on the recommendation of the Babington Smith Committee is affected by the methods of financing Indian trade."

The first and third defects hardly require any further elucidation. As regards the second, the Government held in April 1926, two reserves—the Paper Currency Reserve and the Gold Standard Reserve. Not only was there no meaning in keeping these reserves separately, but they were also separated from the banking reserves of the country. "The Government controls the currency. The credit situation is controlled, as far as it is controlled at all, by the Imperial Bank. With divided control, there is likelihood of divided counsels and failure to co-ordinate."

Taking the fourth defect—*viz.*, the inelastic currency—it is one of the curious features of the Indian currency situation that, in spite of the readiness of Government to issue emergency currency with a view to relieving financial stringency in busy seasons, the financial stringency has often remained unrelieved. Under Section 20 of Act X. of 1923 (amended in 1924), the Imperial Bank of India was entitled to receive funds up to 12 crores of rupees against self-liquidating *hundis* or trade bills. But it was a great defect that emergency currency could not be issued until interest rates were at a certain level. Secondly, the difficulty arose in finding an adequate supply of such bills, because they were

not drawn in large numbers. Trade in India is generally financed by means of cash credits or promissory notes—not *hundis* or bills.

RECOMMENDATIONS

Bearing in mind the foregoing defects of the Indian monetary system, the two outstanding recommendations of the Commission, to which all others are ancillary, were (1) the establishment of a Central Bank and (2) the introduction of the Gold Bullion Standard.

The main object of the establishment of a Central Bank was to provide a unity of policy in the control of credit for the achievement of monetary stability. The new institution called the Reserve Bank of India is now an accomplished fact.

The second important recommendation of the Royal Commission was in regard to the particular monetary system which would best suit the changing conditions of India. This led to the passing of the Currency Act of 1927 which placed an obligation on Government in regard to the purchase of gold and sale of gold or sterling. The Act received the assent of the Governor-General on the 26th March, 1927, and came into force from the 1st April, 1927. As the Currency Act of 1927 was only an amending Act, the following analysis of the position created by it may prove useful.

(1) The silver rupee, the silver half-rupee and currency notes were all legal tender without limit, but open to issue at the will of Government. The parity of exchange was 8.47512 grains troy of fine gold per rupee. (Sections 2, 4 and 12, and 13 of Acts VI, of 1903, III, of 1906, and IV, of 1927 respectively.)

(2) Gold coins were no longer legal tender, but could be received at any Government currency office and at any

Government Treasury other than a Sub-Treasury as bullion at the rate of 8.47512 grains fine gold per rupee. (Section 2 of the Currency Act, 1927.)

(3) Gold in the form of bars containing not less than forty tolas (15 oz.) fine could be offered for sale in unlimited quantities to Government at the Bombay Mint, and Government was under a statutory obligation to buy gold at the rate of Rs. 21-3-10 per tola fine. (Section 4 of the Currency Act, 1927.)

(4) For the first time holders of legal tender currency—i.e., silver rupees and paper notes—were entitled to obtain, on application to the Controller of the Currency, Calcutta, or the Deputy Controller of the Currency, Bombay, either gold at the Bombay Mint or, at the option of Government, sterling for immediate delivery in London, provided they demanded and paid for an amount of gold or sterling of not less value than 1,065 tolas (400 oz.) of fine gold. The purchase price fixed for gold was Rs. 21-3-10, per tola of fine gold. As for sterling, Rs. 21-3-10, was to buy as much sterling as was 'required to purchase one tola of fine gold in London at the rate at which the Bank of England' was 'bound by law to give sterling in exchange for gold, after deduction therefrom of an amount representing the normal cost per tola of transferring gold bullion in bulk from Bombay to London, including interest on its value during transit.' (Section 5 (1) and (2) of the Currency Act, 1927.)

As the latter rate was bound to vary, the Governor-General in Council had to notify from time to time the rate determined as above in the Gazette of India. (Section 5 (3) of the Currency Act, 1927.)

REVIEW OF THE POSITION DURING 1927-31

Since Government had the option of giving sterling and not gold in exchange for rupees—an option which they

actually exercised—the monetary standard of India, as created by the Currency Act of 1927, was, strictly speaking, a sterling exchange standard. But it is fair to point out in parenthesis that so long as sterling did not go off the gold parity, the sterling exchange standard was as good or as bad as the gold exchange standard. Further, if Government chose to exercise the other option open to it of offering gold in exchange for rupees, India would have had, in point of fact, if not in law, a gold standard. Thus the standard of 1927, though a sterling exchange standard, was capable of becoming a gold standard, and certainly indicated that the gold standard was the ideal of Government.

The new standard was superior to that of 1898-1916 inasmuch as there was a statutory gold parity for the rupee and a statutory obligation on Government with regard to the purchase of gold and sale of gold or sterling (itself based on gold.) But the sterling exchange standard still retained most of the old characteristics which had been condemned by the Commission—*viz.*, the conversion of one token currency (silver rupee) into another (paper currency), the duplication of reserves, and the separation of currency from credit control. The Currency Act of 1927 was never intended to be the final currency legislation in India. It was to be supplemented by the other two Acts to which reference has already been made, but unfortunately they did not get enacted. This, then, was the position in India until the recent currency crisis.

5. The Currency Controversy of 1926-31

Ever since the passing of the Currency Act of 1927, there has been unusual public agitation going on against the 1s. 6d. gold ratio and for the 1s. 4d. ratio. The advocates of the 1s. 6d. ratio denied that prices and wages had failed to adjust themselves to the eight grain gold rupee by 1926 :

the opponents of the 1s. 6d. ratio affirmed that the adjustment of prices and wages to the eight grain gold rupee was still to come. Thus the currency controversy was carried on.

But looking back, such statistical analysis as has been made by a number of economists reveals firstly that the adjustment of prices and wages to the 18d. rate was never accomplished; and secondly that the rupee had a very loose grip on the 1s. 6d. gold ratio during the four or five years following its formal introduction. The weakness of the exchange coincided with and was presumably corrected by the large contraction of currency which took place between 1926-27 to 1930-31. Figures of silver currency are not available, but the net contraction of note currency during the quinquennium was no less than Rs. 102.50 crores. This is an unusually large figure, even if allowance be made for the general fall in the price of commodities.

The public mind was much exercised, and the President of the Indian Chamber of Commerce, Calcutta, in his letter dated 26th November, 1930, to the Honourable Finance Member, Government of India, complained that "manipulations of various kinds have been resorted to with a view to create artificial stringency and unjustified high money rates in India." On the 3rd February, 1931, Lala Rameshwar Prasad Bagla asked the following question in the Legislative Assembly: 'Is it a fact that manipulations of various kinds were resorted to by Government with a view to maintain and thereby justify the eighteen pence ratio?' The Honourable Sir George Schuster, Finance Member, replied: 'Government in their capacity as currency authority, and in order to maintain stability of the exchange value of Indian currency, have taken measures of the kind normally employed by currency authorities in all countries with stabilised currencies.'

POSITION OF GOVERNMENT

The position of Government was clear. It was pledged to maintaining the 1s. 6d. gold rupee and it took such measures as were required to redeem its pledge. Doubts were set at rest for the time being when the Secretary of State for India made the following statement in the House of Commons on the 11th February, 1931:

‘The Government regard the rupee question as having been settled in 1927, when the Indian legislature passed the Currency Act by which the rupee was rated at 1s. 6d. gold. The Government will use all the means in their power to maintain this rate in accordance with their statutory obligations.’

6. The Currency Crisis of 1931

A. CRITICAL SITUATION

The beginning of 1931-32 marked the development of a critical situation. Firstly, the economic depression, instead of showing signs of abatement, proved still worse to India owing to the continued catastrophic fall in the prices of its agricultural products with the consequent decrease in the purchasing power and increase in the real burden of debt of the Indian peasantry. At the same time India's normally poor capacity to overcome the evil consequences of an economic crisis had been appreciably reduced by internal disunion and discontent. Attempts were made to alleviate the position by remission of rent and revenue, but the situation was too complicated to admit of an easy solution. Secondly, the collapse of prices and trade caused a serious deterioration in the Governmental budgetary position. The situation was met partly by large short-term loans in the form of treasury bills, which at the end of August 1931 were outstanding at the record figure of Rs. 83.4 crores, and partly by a supple-

mentary budget of taxation and retrenchment presented in September 1931. The budget revealed that a fall in revenue of Rs. 19.55 crores was feared. The position was so serious that economies and taxation were to extend to the end of the financial year 1932-33, and the result then anticipated was that the year 1931-32 would close with a deficit of Rs. 10.17 crores and the year 1932-33 with a surplus of Rs. 5.23 crores, leaving a net deficit of Rs. 4.94 crores. Thirdly, the exchange position was extremely unsatisfactory owing to slackness of trade and lack of confidence, which was responsible for the comparative failure of the sterling loan floated at the end of May 1931.

The position was sufficiently serious: exchange sagged to the lower gold point. On the 27th June the Prime Minister promised support of the British Government to Indian credit and currency, but at that time the British Government was itself experiencing difficulty in maintaining its credit and currency on the gold basis. The flight from the rupee could not be checked, investment in Indian treasury bills on foreign account ceased, and there was a tendency to repatriate the funds already invested. As a last resort, the Government of India had to sell nearly eleven millions sterling to maintain the rupee at the lower exchange point between the beginning of August and the 19th September.

21ST SEPTEMBER, 1931

The 21st September, 1931, will go down to posterity as one of the most important dates in the currency history of India and of many other countries. It was on that day that the world witnessed the divorce of the pound sterling from gold after a brief and unhappy union of over six years. It was on that day again that India had the uncommon experience of the promulgation of a Currency Ordinance. And it was on that very day that the Secretary of State for

India announced the currency policy of India in terms which were not in accord with the Currency Ordinance. India was confused, but the confusion lasted only three days, which were observed as Bank holidays—an event again unprecedented in the annals of Indian currency. On the 24th September, 1931, all speculation and suspense ended with the issue of the Gold and Sterling Regulation Ordinance of 1931.

CURRENCY ORDINANCE OF 1931

On the 21st September the British Parliament passed the Gold Standard Amendment Act and the pound sterling departed from Gold. On the same day the Government of India promulgated the Currency Ordinance of 1931 (Ordinance VI. of the year.) The Ordinance ran as follows:

“Whereas an emergency has arisen which makes it expedient that the Governor-General in Council should be relieved, while the emergency continues, of the obligation imposed upon him by Section 5 of the Currency Act, 1927, to sell gold or sterling when demanded at rates therein fixed, it is hereby enacted as following:

- (1) This Ordinance may be called the Currency Ordinance, 1931.
- (2) Until the Governor-General in Council by notification in the *Gazette of India* direct to the contrary, Section 5 of the Currency Act, 1927, shall have no force.

Since the Government was no longer under a statutory obligation to convert gold into rupees and rupees into gold or sterling, the rupee unless otherwise regulated could not have remained fixed at 1s. 6d. gold or sterling, but would have tended to find its own level in accordance with changed circumstances.

GOVERNMENT POLICY

On the same day that the Currency Ordinance was issued, the Secretary of State for India informed the Federal Structure Sub-Committee in London that the policy of Government in regard to the position of the rupee was as follows :

“.....For all practical purposes the stability of the Indian Exchange has been based on sterling. Indian trade is financed through sterling. The greater part of India's external obligations is in terms of sterling. To follow gold, and so increase the sterling value of the rupee at this juncture is, I am sure you will agree, out of the question. It has therefore been decided to maintain the present currency standard on a sterling basis. I am satisfied that this is the right course for India and is the most conducive to Indian interests.”

The above policy being in conflict with the Currency Ordinance of 1931, that Ordinance, as we have seen, was repealed and another Ordinance was issued on the 24th September, 1931, called the Gold and Sterling Sales Regulation Ordinance.

INDIAN AND ENGLISH CURRENCY LEGISLATION, 1931

It is significant that the Indian Gold and Sterling Sales Regulation Ordinance of 1931 is very similar to the English Gold Standard Amendment Act of 1931 in its main object of maintaining the sterling paper standard by strict regulation of dealings in foreign exchange and the consequent prevention of the export of capital by nationals. This is manifest from the following two extracts from official statements in regard to England and India :

“.....The Government has no reason to believe that present difficulties are due to any substantial extent to ex-

port of capital by British nationals. They desire, however, to repeat emphatically warning given by the Chancellor of the Exchequer that any British citizen who increases the strain on exchanges by purchasing securities himself or assisting others to do so is deliberately adding to the country's difficulties....."

".....There has been evidence for some time of a desire to convert rupees into sterling. The uncertain prospects of such action are illustrated by what has just taken place. Patriotic Indians, however, and all who are zealous for India's well-being and constitutional progress, must realise the importance of maintaining the stability of the currency. They can help by standing by the rupee themselves and by urging their friends to stand by the rupee as well....."

Indian and English currency legislation differed, however, in one material respect, inasmuch as sterling was completely free while the rupee was tied to sterling.

CONTROL OF EXCHANGE

The immediate objective of Government policy was to maintain the sterling value of the rupee at 1s. 6d., the immediate danger being the fear that the Indians might lose confidence in the rupee and convert it into foreign exchange. The situation was met by Governmental control of exchange through discrimination in the sale of foreign exchange. The Imperial Bank of India was authorised to allocate exchange for certain definite purposes and to refuse the sale of exchange for other purposes. According to Ordinance VII of 1931 sales of exchange were limited to (1) normal trade requirements, excluding the import of silver or gold coin or bullion and the liquidation of the over-sold exchange position of any bank in respect of any month subsequent to the month in which the demand for gold or sterling might be

made; (2) contracts completed before the 21st September, and (3) reasonable personal and domestic purposes.

The Rules under the Ordinance (see Appendix II) empowered a Managing Governor of the Imperial Bank to call upon any recognised bank to satisfy him (1) that it had not been selling foreign exchange for any purpose other than those specified above, and (2) that it had been using all its purchases of foreign exchange to cover its sales of foreign exchange before making a demand on the Imperial Bank for gold or sterling. In the event of a Managing Governor being not so satisfied, he was authorised to suspend the recognition of the bank up to seven days and report it immediately to the Governor-General in Council. It must be said to the credit of the exchange banks that they all 'readily co-operated in making this scheme of exchange control effective.' Government was able to stabilise the rupee at 1s. 6d. sterling, but was unable to satisfy public opinion.

PUBLIC OPINION

Public opinion, as voiced by several commercial bodies, was against the policy of linking the rupee to sterling. For instance, on the 6th October, 1931, the East India Cotton Association, Ltd., Bombay, at an extraordinary general meeting passed the following resolution:

"That this extraordinary meeting of the East India Cotton Association, Limited, strongly condemns the decision of the Secretary of State for India as well as the Government of India in linking rupee with paper sterling at 18d., inasmuch as this decision works against the interests of Indian agriculturists in particular. This meeting, therefore, resolves that the rupee be left to seek its own value."

OPPOSITION TO THE NEW SYSTEM

The introduction of the sterling exchange standard met with a strong objection from the non-official members in the

Indian Legislative Assembly. They were naturally indignant that a momentous change in the Indian monetary system had been made by the executive without so much as consulting the legislature. But the Finance Member explained how an emergency had arisen in which immediate action was imperative and the previous public discussion of the measures was not possible.

Public criticism of the new system, however, was not merely sentimental, but was based on several serious considerations. In the first place, the union of the rupee with sterling involved the loss of its freedom for an uncertain and instable career. For this very reason the recent Royal Commission on Indian Currency had declared themselves against a sterling exchange standard, for they apprehended that if ever sterling left the gold basis—which happened to be the case in September 1931—and began to depreciate, 'Indian prices would have to follow sterling prices to whatever heights the latter might soar, or, in the alternative, India would have to absorb some portion of such rise by raising her exchange. India has had experience of both these alternatives, and the evils resulting from them are fresh in her memory.'

This leads to the second point, that in consequence of the depreciation of sterling—i.e., the increase of the sterling price of gold—there was danger of the depletion of India's gold resources. Thirdly, India's gold. With a rupee equal to 1s. 6d. sterling which bought less American or French gold currency than before, it became less profitable for an Indian importer to import goods from America or France which were still on the gold standard than, for instance, from England which had departed from it. In this connexion the following statement of His Majesty's Senior Trade Commissioner in India is both relevant and self-explanatory.

"The linking of the rupee to 1s. 6d. sterling could not fail to act as a powerful stimulus to India's exports to countries which are still on the gold standard, among which are some of her principal customers.—*e. g.*, the United States, Japan, Germany, France and Italy. Conversely, the depreciation of sterling now enables United Kingdom exporters to quote rupee prices below those which in many cases can be quoted by manufacturers and exporters in countries which still adhere to the gold standard, notably Germany, Japan and the United States, who may be regarded as our keenest rivals in the Indian market. Other things being equal, therefore, there should be in terms of rupees a considerable advance in the prices of India's principal agricultural products with a corresponding increase in the purchasing power of the people. This increased purchasing power may be expected to be reflected in a greater demand for imported goods. It is to be hoped that the United Kingdom manufacturer, by reason of this advantage in exchange, will take every opportunity to secure an increased proportion of the trade available."

The fourth and last point of criticism against the sterling rupee is of considerable importance; it was ably put by Mr. R. K. Shanmukham Chetty in the following words :

"The rupee is tied to the chariot wheels of sterling, and in relation to gold it must follow the fortunes of sterling.. I do not anticipate that England will for ever remain off the gold standard. It may be, that after six months or one year or two years England might think that the time had then come for her to go on a gold standard again, and if such a thing happened in England, we will also automatically go on the gold standard; with what consequence? Every country must restore the gold standard and fix its currency in terms of gold with due regard to the economic condition of that

country. But under the present circumstances, irrespective of the economic conditions of India, irrespective of the intrinsic value of our currency, the moment the economic conditions in England become propitious for the linking of sterling to gold, we will automatically be linked to gold. That, I submit, is a danger the possibilities of which are far-reaching and the consequences of which I dread to imagine."

Sir George Schuster, on behalf of Government, made a reassuring statement regarding the preservation of the gold reserves of the country. He admitted that India was placed some what at a disadvantage in regard to her trade with gold standard countries, but he pointed out that she was assured of her trade with England. Moreover, her sterling obligations—both recurring, which were £ 15 millions maturing on the 1st January, 1932, and another £ 7 millions later in the year—were too large to be ignored in determining her currency policy. The alternative to the sterling exchange standard was to let the rupee find its own level. "On the one side there is the policy of drifting, a change of seeing prices rise perhaps higher than they would have if we had remained linked to sterling, but the danger that in order to meet our recurring requirements we should have to draw on our resources, and on the other side the comparative stability of a sterling basis and the assurance of support from His Majesty's Government. But the comparative stability of sterling was disputed, and it was felt that the support of His Majesty's Government need not be dependent on the linking of the rupee with sterling.

COURSE OF EXCHANGE.

Happily, however, sterling and hence the rupee did not depreciate so much as to justify all the fears of the opponents to the new system, whereas the maintenance of a 1s. 6d. gold value for the rupee would have been disastrous. But this does not alter the principle. Since August 1931 the

British people themselves have not been allowed to know on what principles sterling is controlled. The maintenance of a sterling exchange standard therefore means that Indian currency is under the arbitrary control of unknown men in no way responsible to India, who do not even condescend to make any statement about their intentions with regard to its future purchasing power or gold value. This is not a situation with which India can be content.

EFFECT ON INDIAN TRADE.

The opinion of the Senior Trade Commissioner in regard to the effect of the sterling rupee on Indian trade has been given already. It is in strict confirmity with economic theory. What is even more important however, is that it is also in accord with the actual facts. Looking at the Indian trade returns of recent years, it is obvious that there has been diversion of trade in favour of the British Empire and against foreign countries. At the same time the outstanding feature of recent trade has been a decline in the exports of merchandise goods and the unusual exports of gold.

GOLD EXPORTS.

The net exports of gold from India since 21st September, 1931 until December, 1935 amount to over 250 crores of rupees. Such an unusual export of gold gives rise to two important questions. Why has gold left India in such large quantities? How does it affect the interests of the country?

Taking the first question, it is generally held that gold exports have been due to the marked rise in the value of gold. This, however, is only part of the explanation. The Indian people are so conservative by nature and their love for gold in the form of jewellery is so deeply ingrained by age-long tradition that the allurements of higher prices of gold by itself is not enough to draw out their hoards in any large quantities. That a large portion of the gold sales has

been of melted ornaments and jewellery may be taken as an indication of the fact that the sales have been due to dire economic necessity. In other words, the bulk of the people are now living on their past savings or capital. That economic distress should have forced the India peasantry to part with so much of their jewellery is deplorable; that they should have obtained enhanced prices for it is a mitigation of their misfortune.

This leads to the second question as to how the gold exports affect India. On this opinion seems to be divided. But some of the advantages which accrued from the sale of gold are undeniable. In the first place, those who parted with their gold stood to gain by the favourable rates at which they sold it. In the second place, the export of gold tended to help in steadying the value of sterling and therefore the value of the rupee. This, however, would not have been necessary if the rupee were linked to gold. In the third place, the export of gold helped Government in paying off India's sterling debt of £15 millions and thereby raised India's credit. Last but not least, the folly of the undue regard for gold by countries which ought to know better had then begun to be realised. But so long as gold, for good or for evil, remained the basis of currency and credit structure, it would not do for India to deplete her gold resources to any appreciable degree.

Public criticism of the gold export was based on the fact that while by the Gold and Sterling Regulation Ordinance VII. of 1931, Government had intended to prevent the export of capital by nationals and the withdrawal of short term funds by foreigners, this was to a certain extent set at naught by the unchecked gold exports and private withdrawal of foreign capital from India. According to the *Indian Finance*, "Had the control over exchange been lightened, and Government obtained all the remittances resulting

from gold exports and private merchandise account; and had they utilised the surplus over current Home Treasury requirements in the repayment of the external debt, there would have been some justification for Government's policy of *laissez faire*." If, on the other hand, gold exports had been totally prohibited and gold had been bought by Government freely at prices based on the London-New York cross rate, 'the net effect was bound to have been a considerable accession of strength to the Reserve position. The advantages of this policy from the point of view of future monetary reform are obvious, as it would have enabled the Government to establish the Reserve Bank with ample resources at any time they think it fit to do so.' Government's objection to the adoption of such a course—the *Indian Finance* called it a 'theoretical objection'—was that 'the currency authority should not acquire gold at a higher price than that fixed by statute, and that any purchases in contravention of this rule would amount to an unwarrantable speculation in gold.

GOLD AND GOVERNMENT FINANCE

In the foregoing discussion, one point requires separate elaboration. The matter relates to the important part gold exports have played in financing India's external liabilities and will be manifest from an examination of the following trade statistics for the last three years. These statistics, even at a glance, make sad reading, but a little analysis will reveal that they are much worse than they at first sight appear.

IMPORTS	(In lakhs of rupees)		
	1929-30	1930-31	1931-32
Private Merchandise	2,40,80	1,64,79	1,26,37
Gold and Silver	27,60	26,71	7,22
	<hr/> 2,68,40	<hr/> 1,91,50	<hr/> 1,33,59
EXPORTS			
Private Merchandise	3,17,93	2,25,64	1,60,55
Gold and Silver	1,48	2,31	62,61
	<hr/> 3,19,41	<hr/> 2,27,95	<hr/> 2,23,16

The total imports of private merchandise in 1931-32 were less by R. 38 crores (23 per cent.) as compared with 1930-31 and by R. 114 crores (47 per cent.) as compared with 1929-30, while the exports were less by R. 65 crores (29 per cent.) than those in 1930-31 and by R. 157 crores (49 per cent.) than those in 1929-30. Thus both imports and exports—the latter more than the former—were nearly halved in three years, with the result that the excess of Indian exports over imports was more than halved; it fell from R. 77,13 lakhs in 1929-30 to R. 60,85 lakhs in 1930-31, and to R. 34,18 lakhs in 1931-32.

This was a very serious matter for India. As is commonly known, she has every year large sterling liabilities to meet, but her excess of exports of private merchandise over imports in the past used to be adequate not only to meet these liabilities, but also to satisfy her annual demand for the precious metals. If the latter had but remained at the same figure in 1931-32 as it stood in 1930-31 or 1929-30, India could not have met all her sterling liabilities without recourse either to the use of the Gold standard Reserve or to the raising of the sterling credits or both.

As it happened, during 1931-32, not only did India practically give up her usual demand for gold, but she commenced parting with the yellow metal in unheard-of quantities. In 1929-30 and 1930-31 her net taking of gold and silver amounted to R. 26 crores and R. 24 crores respectively. In 1931-32 her net givings were to the extent of R. 57 crores—involving a total sacrifice of R. 81 crores, if compared with 1930-31, and of R. 83 crores, if compared with 1929-30.

Thanks to this unique change in India's attitude towards gold, the visible balance of trade in India's favour, at the end of the financial year 1931-32, amounted to R. 90 crores as

against R. 51 crores in 1929-30 and R. 37 crores in 1930-31. Government was able to satisfy all sterling obligations with perfect ease: the position from this point of view looked extremely satisfactory.

But there is another way of looking at the picture. Until 1930-31 the Indian trade position was such that her normally favourable trade balance was made up of large exports of private merchandise; since 1931-32 the position is that her abnormally favourable balance is made up of large exports of gold which have filled the place of private merchandise of a corresponding value. Granting that gold is also a commodity and gold exports *per se* need not be undesirable, the position is not that exports of private merchandise are being maintained at the old level and *in addition* gold is being exported. The position is that both imports and exports are at a much lower level than before, and gold exports are for the time being masking an otherwise extremely unsatisfactory state of affairs.

This is an impossible situation. How long can it last? Assuming that the price of gold will continue to be high—although by no means a certain proposition—the gold holdings of the people which economic forces can compel and high profits can tempt them to part with are not unlimited. Gold exports are at best only postponing the evil. When they cease, and it should not be very long before they cease—they have already begun to decline—, a situation of the gravest character will arise, if nothing is done to avert it.

7. Conclusion

It will thus emerge from the foregoing analysis that during a great part of a century the Indian Currency has been marked by uncertainty as well as instability, and it has failed to inspire confidence among the people as it has lagged in the service of trade and industry. These drawbacks

have been particularly pronounced since the end of the War, *i. e.*, 1920 and while it must be admitted that no country may claim to have possessed an ideal or even a satisfactory monetary standard during the last 15 years, the monetary policy of India has been at best one of drift, and it has not been an aid in relieving the depression so disastrous to Indian agriculture.

At the end it must be stated that the present monetary position is temporary, and while, since the 1st of April, 1935 the management of Indian Currency has been entrusted to the newly established Reserve Bank of India, it means at present only an improvement in technique. The preamble of this Act points out that a stable monetary system is still to come when the international situation permits it. How long this may take, no one can tell, and in the meantime something needs to be done.

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